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No. 91-321

In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Writ of Certiorari to the Supreme Court of Tennessee

BRIEF OF PETITIONER

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QUESTIONS PRESENTED

1. Whether the Customs Conventions on Containers preempt the imposition of a state sales tax upon the lease of cargo containers that enter the United States under Customs bond and are used exclusively in foreign commerce.
2. Whether the imposition of such a tax is prohibited by the Foreign Commerce Clause.
3. Whether the Import-Export Clause prohibits the imposition of a state sales tax on imported or exported goods while they are in transit.

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On Writ of Certiorari to the Supreme Court of Tennessee

BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee is reported at 814 S.W.2d 29. It is reprinted in the appendix to the petition for a writ of certiorari at 1a-18a. The unreported opinion of the Tennessee Court of Chancery appears at Pet. App. 19a-26a.

JURISDICTION

The judgment of the Tennessee Supreme Court was entered on April 22, 1991. On July 10, 1991, Justice Stevens extended the time within which to file the petition to and including August 21, 1991. The petition was filed on August 21, 1991, and the Court granted the petition on February 24, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

The relevant portions of the following constitutional, statutory, and regulatory provisions are reproduced in the appendix to the petitition at 38a-44a: the Foreign Commerce Clause (Art. I, § 8, Cl. 3), the Import-Export Clause (Art. I, § 10, Cl. 2) and the Supremacy Clause (Art. VI, Cl. 2) of the United States Constitution; the Customs Convention on Containers, Dec. 2, 1972, [1985] 988 U.N.T.S. 43; the Customs Convention on Containers, May 18, 1956, [1969] 20 U.S.T. 301; 19 U.S.C. 1322(a); 19 C.F.R. 10.41a; 19 C.F.R. Pt. 115; and Tenn. Code Ann. 67-6-102(23)(A) (1989).

STATEMENT OF THE CASE

This case represents a collision between the power of the Federal Government and of a State to regulate foreign commerce. Tennessee has imposed a sales tax on the lease of Customs bonded and sealed cargo containers used exclusively and continuously in foreign commerce. The United States and 58 other nations have signed two treaties that prohibit the imposition of taxes in connection with the importation of cargo containers. Tennessee is the only State—and indeed the only subnational unit within the borders of the 59 signatory nations to these treaties—that imposes such a tax. Tennessee's sales tax assessment is prohibited by the 1956 and 1972 Customs Conventions on Containers (the "Container Conventions") and is inconsistent with the objectives promoted by the comprehensive scheme of regulation emanating from the Conventions.

Further, Itel contends that the tax violates the Foreign Commerce and Import-Export Clauses of the United States Constitution. Because Tennessee taxes the full value of a transaction with substantial taxable nexus around the globe, it creates a risk of international multiple taxation. In addition, most container lessees, who

in large part absorb the tax, are foreign domiciliaries. The exaction of the tax therefore both creates an asymmetry in international taxation of containers and threatens to prompt retaliation by our trading partners against American firms.

The Container Revolution. Cargo containers are specifically manufactured steel boxes (typically eight feet high, eight to 9.5 feet wide and between eight and 40 feet long), that are used as articles of transport equipment. See *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 436 n.1 (1979). Because they are reusable, may be loaded and unloaded mechanically, and are designed to be carried by truck, rail and oceangoing vessel, containers have greatly reduced the cost of shipping cargo. See Simon, *The Law of Shipping Containers*, 5 J. Mar. L. & Com. 507, 513 (1974). Containerization provides a number of significant economies in the transport of cargo: elimination of intermediate repacking and handling between the points of origin and destination; ease of storage on oceangoing vessels; reduction of damage to cargo resulting from manual handling; elimination of expensive, disposable packaging; and speedy loading and discharging, which reduces the idle time of a vessel and crew while in port. See Simon, *supra*, at 510-13.

While permanent, reusable cargo containers were in use for many years, "[w]ith the container revolution of the 1960's, large containers and specially-built container ships to accommodate them came into use." *Summary Record of the First Plenary Meeting*, [1972] U.N. Doc. E/CONF.59/SR.1 at 7 (United Nations/IMCO Conference on International Traffic, considering the 1972 Convention). This revolution, described as "[one] of the most important technological developments in the transportation of goods by sea since steam replaced sail" (see Simon, *supra*, at 507), has fueled a boom in international imports and exports. "It would be difficult to overestimate the impact on virtually all phases of international

trade of the dramatic expansion * * * of the use of large, intermodal freight containers." Sen. Comm. on Foreign Relations, Exec. Rep. No. 33, 94th Cong., 2d Sess. 4 (1976) (statement of John B. O'Loughlin, Acting Assistant Commissioner (Operations), U.S. Customs Service).

The United States is a world leader in container use; containers now provide the principal means for marine transportation of U.S. imports and exports. Containers carried 60% of the value of American marine imports and 52% of the value of American marine exports in 1990. Bureau of the Census SM705. The value of American goods exported by container in 1990 exceeded $84 billion. *Ibid.* Containers were used for the marine transport of a variety of crucial American exports in 1990: 59% of the value of exported chemicals and related products, 61% of the value of exported machinery and transport equipment, 69% of the value of manufactured goods and 89% of the value of exported beverages and tobacco were carried in containers. *Ibid.* More than 25% of these containers, with a replacement value of approximately $3.2 billion, are owned by firms domiciled in the United States. Br. of Cronos Containers, *et al.*, at 4.

The Container Conventions. The United States and many of its trading partners have for several decades provided special benefits to containers by treaty. In fact, the "need for providing for the temporary importation of containers free of import duty and taxes, and for harmonizing or unifying technical provisions applicable to containers used for transport under Customs seal was felt in Europe well before the advent of the 'Container Revolution.'" U.N. Doc. E/CONF.59/2 at 1 (Feb. 22, 1971). Twelve European nations originally signed the 1956 Customs Convention on Containers (the "1956 Convention"), May 18, 1956, [1969] 20 U.S.T. 301. The 1956 Convention entered into force with respect to the United States on March 3, 1969.

Article 2 of the 1956 Convention requires each signatory nation to "grant [containers] temporary admission free of import duties and taxes and free of import prohibitions and restrictions." 20 U.S.T. at 304. The Convention defines the term "import duties and import taxes" to mean "not only Customs duties, but also all duties and taxes whatsoever chargeable by reason of importation." *Ibid.* The legal fiction of temporary importation thus prevents containers from entering the domestic commerce of any signatory nation.

The 1972 Convention, which entered into force with respect to the United States on May 12, 1985,[1] expanded the prohibition of container taxation. The 1972 Convention's definition of prohibited "import duties and taxes" encompasses "Customs duties *and all other duties, taxes, fees and other charges* which are collected on, or in connexion with, the importation of goods, *but not including fees and charges limited in amount to the approximate cost of services rendered.*" 988 U.N.T.S. at 44 (emphasis added). The 1972 Convention requires strict regulatory compliance to qualify for these benefits, generally providing that containers must be re-exported within three months of their importation (see art. 4, *id.* at 45) and limiting their use in internal traffic (see annex 3, *id.* at 52).[2] Including the United States, 59 nations now are signatories to one or the other of the Container Conventions. See U.S. Dept. of State, *Treaties in Force* 303-305 (1990).

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[1] The United States signed the 1972 Convention on December 5, 1972. Upon entry into force, the 1972 Convention replaced the 1956 Convention in relations between the parties to the 1972 Convention. See 1972 Convention, 988 U.N.T.S. at 48.

[2] The 1972 Convention also provides for the admission of container parts and accessories (art. 10-11, 988 U.N.T.S. at 46), the approval of containers used to transport goods under Customs seal (art. 12, *id.* at 47; Annex 5, *id.* at 61-67), the marking of containers (Annex 1, *id.* at 51-52), the obligations of container owners (Annex 2, *id.* at 52), and the design of containers (Annex 4, *id.* at 52-61).

The Conventions have been implemented in the United States by statute and regulation. The Secretary of the Treasury, acting pursuant to 19 U.S.C. 1322(a), has designated containers as "instruments of international traffic" that are excepted from application of the Customs laws. 19 C.F.R. 10.41a(a)(1), (3). To receive this special treatment, however, a container owner must provide assurances that its containers will not be used in interstate or intrastate commerce; if the containers are diverted to point-to-point local use within the United States, the owner must make entry and pay the applicable Customs duty. Each owner must post a continuous bond with the Customs Service to secure compliance with this undertaking. 19 C.F.R. 10.41a(a), (c), 113.66. In addition, 19 C.F.R. pt. 115 implements the 1972 Convention's procedures for the certification and approval of containers used in transporting goods under Customs seal. Compliance with these procedures allows steamship lines to move containers from the point of loading to the ultimate destination without the presentation of papers to, or inspection by, Customs officials.[3]

Itel's Business. Itel[4] is a Delaware corporation with its principal place of business in California. Stip. 4, Pet. App. 27a.[5] During the relevant period, it leased cargo

[3] "It is not surprising that containerization * * * has impacted on worldwide customs procedures. Containers are designed for uninterrupted movement of large unit loads of goods over potentially great distances without the need for customs authorities to carry out their controls using traditional methods. Obviously, if containers were opened and the goods examined at every frontier or port, the efficiency gained through containerization would be nearly completely lost." Exec. Rep. No. 94-33, *supra*, at 4.

[4] Itel's Rule 29.1 statement appears in the Petition at ii.

[5] Itel submitted an extensive stipulation of facts, presented testimony of two witnesses and introduced 27 exhibits which were admitted without objection at trial. Stip. 92; Trial Transcript ("Tr.") 21, 22, 52, 53, 87. The Tennessee Department of Revenue offered no testimony or exhibits in rebuttal. Tr. 99.

containers that were used exclusively in foreign commerce by steamship lines. The containers were manufactured and purchased abroad by Itel, and entered the United States certified for the transport of goods under Customs seal. Itel posted a continuous bond with the Customs Service undertaking not to withdraw its containers from foreign commerce. All of Itel's leases accordingly restricted use of the containers to international commerce. Stip. 72-73, Pet. App. 34a. The leases were solicited and negotiated through marketing offices in California, Texas, Illinois, New Jersey, South Carolina and Washington; none of the leases during the relevant period was solicited, negotiated or executed in Tennessee. Stip. 3, 41; Pet. App. 27a, 31a. In addition, Itel operated container terminals and made use of so-called "third-party" terminals—facilities operated by independent contractors that tendered delivery and accepted returns of containers —worldwide.

Itel operated one terminal and used several third party terminals in Tennessee.[6] Containers were delivered at those points to common carriers hired by Itel's lessees. Eighty percent of the lessees who accepted delivery of Itel's containers in Tennessee were international steamship lines domiciled in foreign countries, including companies domiciled in Australia, Colombia, France, Germany, Iceland, Israel, New Zealand, Norway, Singapore, Sweden, Switzerland, the United Kingdom, and Venezuela. Tr. 31-33. While each container initially was used to export American goods to foreign ports, most containers were used continuously in multiple import-export shipments. All of Itel's leases culminated with an import

[6] For the greater part (January 1, 1983-June 30, 1985) of the audit period, Itel did not have any employees or terminals located in Tennessee. Stip. 31, Pet. App. 31a. Before July 1, 1985, Itel allowed its containers to be delivered and picked up at two or three third party depots located in Tennessee. Stip. 32, Pet. App. 31a. During the latter portion of the audit period, Itel leased real property and buildings located in Memphis and employed four persons to operate the terminal. Stip. 33-35, Pet. App. 31a.

shipment terminating in a Customs Convention signatory nation; 61% of the leases concluded with an importation into the United States.[7]

The Assessment. In 1986, the Tennessee Department of Revenue assessed $382,465 in sales taxes, penalties and interest on the proceeds earned from the lease of containers that Itel delivered in Tennessee to international carriers.[8] Tennessee's 5.5% sales tax is imposed on "any transfer of title or possession, or both, exchange, barter, lease or rental * * * for a consideration." Tenn. Code Ann. 67-6-102(23)(A) (1989).[9] While Itel is obligated to collect the tax from its lessees "insofar as it can be done" (Tenn. Code Ann. 67-6-502 (1971)), the legal incidence of the tax falls on Itel, and only Itel may contest its imposition. *See Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Itel accordingly paid the tax under protest and began this action for a refund, challenging the constitutionality of the tax under the Commerce, Import-Export, and Supremacy Clauses of the United States Constitution. The Tennessee Chancery Court reduced the assessment on state law grounds but rejected the federal constitutional claims, sustaining a revised assessment of $158,012. Pet. App. 19a-26a.

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[7] Trial Exhibits ("Ex.") 7, 13, 15 and 22 indicate the location for each container redelivery.

[8] Stip. 1, 84; Pet. App. 27a, 35a. A sample transaction drawn from the audit period is illustrative. On March 5, 1985, the Shipping Company of New Zealand accepted possession of a 40′ Itel dry van container. The container was loaded onto the chassis of a common carrier hired by the steamship line, loaded with cargo and carried by rail to an international port. The container then traveled the globe until it was returned at Itel's San Francisco terminal on May 5, 1986. Because the lease term was 427 days and Itel charged $3.50 per day, the steamship line paid $1,494.50 for the use of the container from the first importation to the return of the container in San Francisco. Tennessee's sales tax totaled 5.5% of the gross proceeds, or $82.20. Ex. 7, 13, 15.

[9] Petitioner already was paying sales and use taxes on fees collected in connection with repair services performed at its Memphis terminal. Stip. 38, Pet. App. 31a. Those taxes are not at issue here.

The Opinion Below. The Tennessee Supreme Court affirmed. Pet. App. 1a-8a. It recognized this Court's holding in *Japan Line* that a state ad valorem property tax on containers owned by foreign domiciliaries violates the Foreign Commerce Clause. The court also acknowledged that "Itel's containers, like Japan Line's containers, are instrumentalities of foreign commerce" (*id.* at 7a), and it expressly declined to distinguish *Japan Line* on the ground that in this case the tax happens to fall on a domestic domiciliary. *Id.* at 7a-8a. Instead, the court found a constitutional distinction between sales and property taxes (see *id.* at 12a), holding that state sales taxes by their very nature satisfy the requirements of the Foreign Commerce Clause because they pose no risk of multiple taxation (*id.* at 14a-15a) and cannot interfere with the federal government's management of foreign relations or international trade. *Id.* at 15a-16a.

The court next held that the Tennessee tax was not preempted by the Container Conventions and the Treasury Department's implementing regulations. It distinguished this Court's decisions in *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), and *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940) (which held state property and sales taxes preempted by federal statutes that exempted goods from Customs duties when stored under bond in designated warehouses), finding that federal regulation of Customs bonded containers is "less pervasive" than the regulation of Customs bonded warehouses. Pet. App. 14a. The court also reasoned that preemption is inappropriate because the Container Conventions were not intended to benefit container owners. *Id.* at 10a.

Finally, the court turned aside Itel's claim under the Import-Export Clause. In rejecting the argument that the Tennessee tax is invalid under *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), the court below evidently concluded that *Richfield's* holding did not survive this Court's more recent decisions in

Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), and *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978). See Pet. App. 16a-17a. And in applying the Import-Export Clause test set out in *Michelin*, the court again found it dispositive that the tax at issue here is one on sales rather than on property. *Id.* at 18a.

SUMMARY OF ARGUMENT

I. Tennessee's sales tax imposed on container leases is repugnant to both the letter and the spirit of the Container Conventions, treaties between the United States and 58 other nations. The Conventions expressly prohibit the imposition of taxes collected "by reason of" or "in connexion with" the importation of containers. The 1972 Convention allows the signatory nations to impose only taxes "limited to the approximate cost of services rendered." Tennessee's sales tax is levied "by reason of" or "in connexion with" the importation of containers; the containers would not be subject to taxation but for their importation into Tennessee, and the tax is assessed upon the entire value of container leases throughout a continuous series of import/export shipments. This reading of the Conventions is confirmed not only by their plain language, but also by the uniform custom of the signatory nations.

Aside from the Conventions' express prohibition, Tennessee's sales tax is preempted because it undermines the principal objectives of the Conventions and the federal regulatory scheme. The impact of Tennessee's tax is substantial enough to erase the very benefit provided by Congress—the waiver of Customs duties. And by substantially increasing the cost of container transport, the tax discourages container use in foreign commerce, places American container owners at a competitive disadvantage, and stunts American export trade—the precise objectives the United States seeks to promote. It is manifest that Tennessee's tax is preempted by the force of

this Court's reasoning in *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), and *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982).

II. In addition, like the California property tax at issue in *Japan Line*, Tennessee's sales tax violates the Foreign Commerce Clause because it creates an unacceptable risk of international multiple taxation and prevents the United States from speaking with one voice with respect to its foreign trade. Tennessee's tax on the full value of container leases invites multiple international burdens; many foreign nations have a sufficient taxable nexus to impose equivalent taxes upon the lease proceeds —and would, in fact, impose such taxes were it not for the prohibitions of the Container Conventions. The Tennessee sales tax, moreover, whether imposed on foreign container lessors or lessees, will inevitably lead to foreign retaliation felt not just by Tennessee, but by the United States as a whole. Such retaliation already has been at least implicitly threatened. And the United States, of course, cannot "speak with one voice" with respect to foreign trade if Tennessee and other States subject containers to "various degrees of multiple taxation, depending on which American ports they enter." *Japan Line*, 441 U.S. at 453.

III. Finally, Tennessee's direct tax on "in-transit" containers violates the Import-Export Clause—not only because it prevents the Federal Government from speaking with one voice, but because it is "no more than [a] transit fee[] on the privilege of moving through a State." *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 290 (1976). The Court has never construed the Clause to permit the type of tax imposed by Tennessee. Under both the Court's modern analysis and the Court's holding in *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), which is indistinguishable from this case, a state sales tax on an in-transit export or import violates the Import-Export Clause.

ARGUMENT

I. THE TERMS AND OBJECTIVES OF THE CONTAINER CONVENTIONS PREEMPT THE IMPOSITION OF TENNESSEE'S SALES TAX

State regulations that "actually conflict[] with federal law" must fall. *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982). Tennessee's tax—which is "collected on, or in connexion with, the importation of goods" [10]—is preempted because it is flatly inconsistent with the plain terms of the Container Conventions. In fact, Tennessee's application of its sales tax to the leasing of containers engaged in foreign commerce is a remarkable departure from what has been universal practice under the Conventions. For the 36 years that one or the other of the Conventions has been in effect, so far as we have been able to determine, *not one* of the 59 signatories or their innumerable political subdivisions has imposed such a tax. But even without regard to the clear language of and consistent practice under the Conventions, Tennessee's tax is preempted because it "offset[s] substantially the very benefits Congress intended to confer" by excepting cargo containers from customs duties. *Xerox Corp. v. Harris County*, 459 U.S. 145, 153 (1982).

A. The Tennessee Tax Cannot Be Reconciled With The Language Of The Conventions

When interpreting a treaty, this Court begins "with the text of the treaty and the context in which the written words are used." *Air France v. Saks*, 470 U.S. 392, 397 (1985). Here, the 1956 Convention provides for the temporary admission of containers free of import duties and taxes, which are defined as "not only Customs duties but also *all duties and taxes whatsoever* chargeable by reason of importation." 20 U.S.T. at 304 (emphasis added). The 1972 Convention offers a similar but broader

[10] 1972 Convention, Art. 1(b), 988 U.N.T.S. at 44. The prohibition expressed in the 1956 Convention is similar, prohibiting all "taxes whatsoever chargeable by reason of importation." Art. 1(a), 20 U.S.T. at 304.

description of the proscribed taxes, prohibiting the imposition of "Customs duties *and all other duties, taxes, fees and other charges* which are collected on, or in connexion with, the importation of goods." 988 U.N.T.S. at 44 (emphasis added). The 1956 Convention ensures a broad interpretation of the prohibition by modifying "all * * * taxes" with the adjective "whatsoever." The 1972 Convention also proscribes "all" taxes and then makes the prohibition as inclusive as possible by the reference to "fees and other charges."

The Container Conventions do not except taxes imposed by subnational units, such as States. To the contrary, "all * * * taxes" are prohibited. The breadth of the prohibition is magnified by the 1972 Convention's sole, narrow exception of "fees and charges limited in amount to the approximate cost of services rendered" (988 U.N.T.S. at 44), an exception that has no bearing here. If the parties to the 1972 Convention intended to allow sales or transaction taxes on container transfers, they could easily have expanded the exception clause.

Tennessee's sales tax is "chargeable by reason of importation" and collected "in connexion with the importation of goods." The texts of the Conventions recognize that the concept of importation describes the continuous status of a container while present in a signatory nation, not a discrete event temporally related to the crossing of a border. Article 3 of the 1956 Convention describes containers as "temporarily imported" when they are within national borders. Article 1(b) of the 1972 Convention similarly describes the containers as subject to "temporary importation." Under the fiction of "temporary admission," the containers remain temporarily imported throughout their stay in the United States. Thus, when Tennessee's tax was imposed, Itel's containers were temporarily imported goods.[11] Further, the tax here—which attaches only when containers physically are transferred

[11] The containers' status as temporarily imported goods is not changed upon leasing for re-export from the United States.

in Tennessee—is triggered in a direct sense by the entry of goods into the taxing jurisdiction; it is the containers' visit to Tennessee that (in part) is responsible for the tax. And a tax that is assessed only because the taxed good entered into the taxing jurisdiction surely is one that is imposed "by reason of" or "in connexion with" importation.

In addition, because Tennessee makes no effort to apportion its sales tax to the fraction of the lease term during which a container is present in Tennessee or the distance traveled by the container—and because all of Itel's leases culminated with an importation to a Container signatory nation—its sales tax necessarily is imposed "by reason of" or "in connexion with" one or more importations. Ex. 7, 13, 15, 22. Thus, Tennessee's tax was imposed upon the time-value of "temporarily imported" containers throughout the term of each lease.

Indeed, the court below sensibly did not take issue with the proposition that Tennessee's sales tax on containers is one imposed "by reason of" or "in connexion with" the importation of the containers. Instead, the court avoided a finding of preemption only by pointedly ignoring the Conventions' language, which the court nowhere so much as mentioned. But when the language *is* considered, it seems self-evident that the levy—which undoubtedly is a "tax" within the meaning of both Conventions—must be preempted.[12]

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[12] Although we find the Conventions unambiguous on this point, it is worth adding that any doubt should be resolved in favor of preemption. *Cf. Air France*, 470 U.S. at 396 (treaties "are construed more liberally than private agreements"). Treaties must be construed to effectuate the intent of the signatories—signatories that are not concerned with respecting principles of American federalism. In contrast, preemption is disfavored in cases involving federal statutes because Congress is presumed not to have sought to displace state law. Consequently, as the Court has noted in finding a state tax preempted by a treaty: "When a treaty provision fairly admits of two constructions, one restricting, the other enlarging rights which may be claimed under it, the more liberal interpretation is to be preferred. [Citations omitted.] And as the treaty-making power is independent of and superior to the legislative power of the States, the meaning of treaty provisions so construed is not restricted by any necessity of avoiding possible conflict with State legislation, and when so ascertained must prevail over inconsistent State enactments." *Nielsen v. Johnson*, 279 U.S. 47, 51-52 (1929).

The "actual, reasonably harmonious practice adopted by the United States and other signatories" to the Conventions confirms this interpretation. *Trans World Airlines, Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 259 (1984). *None* of the 59 signatories—or their subnational units, with the sole exception of Tennessee—has sought to tax the transfer of containers. To the contrary, those nations and their political subdivisions, including the principal trading nations of the European Community and Japan, have affirmatively exempted from their sales and use tax equivalents all transactions involving containers that are engaged in international commerce.[13]

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[13] The member countries of the European Community, for example, have adopted a suggested uniform system of value added taxation that imposes "output" and "input" taxes, which are collected in a manner similar to sales and use taxes. O.J. European Comm. (No. L 145) arts. 2, 6 (1977) (Sixth Directive 77/388). *Cf. Trinova Corp. v. Michigan Department of Treasury*, 111 S. Ct. 818, 825 n.3 (1991). The leasing of goods is considered a taxable supply of services. See Sixth Directive art. 6. The Community nevertheless honors its member countries' obligations under the Conventions by exempting from value added taxation (1) imported goods that qualify for Customs duty exemptions and (2) supplies of services that are directly linked to the transit or export of goods. *Id.* arts. 14(I)(c), 15(1). See United Kingdom Br. 7-8 & n.14 (explaining operation of and exemptions to VAT). Similarly, Japan grants an exemption under its consumption tax to rents from the lease of containers that are used in international commerce. Consumption Tax Law, art. 17(2)(ii). Eleven of our principal trading partners have lodged a diplomatic note with the State Department protesting the Tennessee tax and representing that, "[c]onsistent with obligations under the Conventions, neither the Governments [signatory to the note] nor any political subdivisions impose sales taxes (or equivalent taxes of different nomenclatures) on the lease of cargo containers that are used in international commerce among the Contracting Parties to the Conventions." (A copy of the note is appended to the brief filed by the United Kingdom in this case.)

This uniform practice cuts powerfully in favor of preemption here. *Cf. O'Connor v. United States*, 479 U.S. 27, 33 (1986); *Air France*, 470 U.S. at 403; *Trans World Airlines*, 466 U.S. at 260.

Indeed, we have more in this case than the implicit endorsement of our reading that may be derived from the custom of nations. Eleven of our most significant trading partners have lodged a note with the State Department explaining their "view that the application of Tennessee's sales tax to leases of international-commerce cargo containers is in direct contravention of the Government of the United States' undertakings in these Conventions." (A copy of the note is appended in the brief filed in this case by the United Kingdom.) And the United Kingdom, a signatory to the 1956 Convention and one of the world's leading maritime nations, has informed the Court expressly that

> International-commerce containers leased while in Tennessee are there precisely "by reason of importation," having entered the U.S. in the course of their continuous use in the cross-border commerce that the Convention is designed to facilitate. The presence of a marine container, for example, in Tennessee is due to its "temporary admission" into the United States under Article 3 of the Convention, which allows entry of a container into the territory of a Contracting Party for only a limited time (up to three months) before it once again embarks on a journey on the high seas *en route* to the territory of another Contracting Party. In other words, the container is in Tennessee only by reason of the fact that it has been imported as an international-commerce container, *i.e.*, "by reason of importation."

Br. of the United Kingdom ("U.K.") 7. In these circumstances, it would be "particularly inappropriate for a court to sanction a deviation from the clear import of a solemn treaty between this Nation and * * * foreign sovereign[s], when, as here, there is no indication that

application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories." *Maximov v. United States*, 373 U.S. 49, 54 (1963).

B. The Executive Branch and Congress Intended to Preempt State Regulation of Federally Bonded Containers Used Exclusively in Foreign Commerce

1. *The Tax Is Inconsistent With The Objectives of the Container Conventions*

Tennessee's tax is not invalid only because of the express language of the Conventions. It is equally preempted if, "under the circumstances of this particular case, [the tax] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" and the Executive Branch. *Hines v. Davidovitz*, 312 U.S. 52, 67-68 (1941). Tennessee's tax presents such an obstacle.

The "container revolution" was driven by tremendous savings in labor costs due to the elimination of intermediate loading and unloading of cargo. Nevertheless, transporting goods by container carried its own unique disadvantage. The reusable metal containers are themselves valuable articles that were subject to duties and taxes imposed as they travelled the oceans and continents—levies that would add to the cost, and thus discourage the use, of container transport.

The signatories to the 1956 Container Convention desired generally to "develop and facilitate the use of containers in international traffic" by addressing this very problem. The Convention accomplishes this goal by reducing the cost of container use through the broad prohibition of duties and taxes. In recommending that the Senate consent to the United States' accession to the treaty, President Lyndon Johnson recognized that the protections provided by the 1956 Convention not only

aided container transport generally but also were "of special importance to those Americans engaged in business in foreign countries" and would "aid the American export drive." President's Letter of Transmittal, 1956 Customs Convention on Containers, 89th Cong., 2d Sess. (June 30, 1966), *reprinted in* 108 Journal of the Executive Proceedings of the Senate, Pt. 1 at 668, 669 (1966). The Senate thus consented to this country's accession to the 1956 Convention both to "simplify[] and facilitat[e] the movement of goods in international trade" generally and to provide "direct benefit to American business interests in the territories of other parties to the convention[]." S. Rep. No. 1618, 90th Cong., 2d Sess. 2 (1968). After its ratification, the 1956 Convention was implemented in the United States by Treasury Department regulations designating containers "instruments of international traffic" (19 C.F.R. 10.41a(a)(1)) and by a statute excepting such instruments from application of the Customs laws. 19 U.S.C. 1322(a).

Pointing to this regime, the United States explained to this Court in *Japan Line* that "[a] state tax [on containers] would frustrate accomplishment of the federal objective" (No. 77-1378, U.S. Br. 28) and therefore "conflict[] with the spirit and design of the federal scheme." *Id.* at 29 (footnote omitted). The Court agreed, quoting from the 1956 Convention's provision prohibiting import duties and taxes and concluding that the "Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 453. The Court, utilizing "a species of pre-emption analysis" (*Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 194 (1983)), reasoned that California's property tax on containers placed "impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

Since that time, the international proscription on local regulation of containers has become considerably *stricter*

with ratification of the 1972 Container Convention. Adoption of the 1972 Convention was prompted by "the considerable increase in numbers of containers used in international traffic" and the "need both for simplifying Customs formalities and facilitating container transport." U.N. Doc. E/CONF. 59/2 (Feb. 22, 1971), at 1 (Note by the Secretariat). As the United States noted in its comment on the draft 1972 Convention, the revision of the 1956 treaty was designed to "contribute significant economic benefits to the development and facilitation of international container traffic on a global basis." U.N. Doc. E/CONF. 59/16 (Nov. 26, 1971), at 2.[14] The preamble to the 1972 Convention thus affirms the treaty's purpose "to develop and facilitate international carriage by container" (988 U.N.T.S. 43, 44), which it accomplishes, in part, through its prohibition of "Customs duties and all other duties, taxes, fees and other charges" on containers. *Ibid.*

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[14] The United States further explained that its "role in the evolution of the container system" is "dedicated largely to eliminating the artificial barriers which the division of the world into nation States poses for efficient movement and trade." U.N. Doc. E/CONF.59/IPG.2, Annex at 14 (Feb. 14-18, 1972). With regard to the contemporaneously-drafted International Convention for Safe Containers, Dec. 2, 1972, [1979] (39 U.S.T. 3707), which establishes safety standards for containers, the United States similarly commented that "[a] plethora of dissimilar national regulations would work great hardship upon the international system and would be at variance with the objective of facilitating container traffic on a global basis." U.N. Doc. E/CONF.59/IPG.2 at 15 (Feb. 14-18, 1972). With respect to the proposed draft convention on the International Combined Transport of Goods, the United States expressed related goals: "The United States Government strongly supports the further development of containerization which promises so much in reducing unit transport cost. * * * It sees containerization as having a profound effect in the transport system through the technology and possibilities for efficiency inherent in it. Consequently, it maintains that the legal and documentary regime governing the use of this transport should be as forward-looking as the technology." U.N. Doc. E/CONF.59/24 at 3 (June 23, 1972).

The United States entered into the 1972 Convention, as it had the 1956 Convention, both generally to encourage the use of containers and specifically to promote the interests of American container owners. The Department of State and the Senate both concluded not only that the 1972 Convention "should contribute significantly to the development of international container traffic on a global basis," but also that "[a] primary effect of the Convention will be to facilitate the use of United States-owned and operated containers in international traffic by ensuring that they receive treatment in the territories of the Parties to the Convention similar to that which is afforded to foreign-owned containers in the United States at the present time." Message from the President of the United States Transmitting the Customs Convention on Containers, 1972, and the International Convention for Safe Containers, both signed at Geneva on Dec. 5, 1972, Exec. X, 93d Cong., 1st Sess. vi (1973); Exec. Rep. No. 94-33, at 1.

Against this background, it is manifest that the imposition of a tax on the transfer of containers would frustrate federal policy in the most direct imaginable manner: it would add expense to a transaction that Congress intended to be cost-free—and it would substantially reduce the very benefit that Congress intended to confer by exempting containers from *federal* Customs duties. The magnitude of this effect may be demonstrated on the record here. During the tax audit period, reusable cargo containers of the kind leased by Itel were subject to Customs duty unless otherwise exempted. General Headnotes 6(a) and (b)(ii) to the Tariff Schedules of the United States (TSUS). Ad valorem Customs duties during the audit period ranged from 2.5% to 0.6%. TSUS 640.30. Because the replacement value of the containers leased during the audit period was $11,189,172, the Customs exemption benefited Itel by some $178,550.[15]

[15] The Tennessee Department of Revenue audited the delivery of Itel's containers in Tennessee from January 1, 1983 through November 30, 1986, examining lease transaction data from two one-month test periods (Feb. 15-Mar. 14, 1985 and Mar. 1986). Itel transferred possession of 122 containers in Tennessee during the two test months. The container leases establish replacement values ranging from $2,875 to $6,560 for each container. The United States Customs Service calculates the dutiable "transaction value" of imported leased goods by determining the consideration that would be paid to purchase identical goods. 19 C.F.R. 152.101(b). By projecting the number and replacement value of the containers leased during the test months for the full 47-month audit period, and by applying the prevailing duty rates during each calendar year (2.5%, 1.9%, 1.3% and 0.6%, respectively), the duties may be estimated. See TSUS 640.30; Tr. 33; Ex. 7, 13, 15, 22.

By comparison, Tennessee's revised sales tax assessment was $158,012, which nearly erased the benefit provided by the Customs duty exemption. This charge on the transfer of containers that have entered Tennessee surely is an "impediment[] to the use of containers" in international traffic. *Japan Line*, 441 U.S. at 453, discourages the "use of American-owned containers" and frustrates the "American export drive."

2. McGoldrick *and* Xerox

In circumstances that are in all relevant respects identical to those here, this Court has invalidated state taxes that substantially reduce economic benefits provided by Congress. In *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), and *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), the Court held state sales and property taxes on Customs bonded goods preempted by the federal Customs bonded warehouse statutes. The federal statutes at issue in those cases excepted the bonded goods only from Customs duties; the state sales and property taxes at issue were not expressly prohibited.[16]

[16] The *McGoldrick* Court did not rely upon Art. 942 of the Customs regulations that exempted bonded warehouse goods from state taxation, stating that the regulations expressed "only what is implicit in the congressional regulation of commerce." 309 U.S. at 429. The Treasury Department later deleted the regulation exempting State taxation, effective December 1, 1982. The deletion of the regulation

The *McGoldrick* and *Xerox* Courts examined the federal objectives promoted by the Customs duty exemptions to determine whether the state taxes were inconsistent with them. The purpose of the exemption in *McGoldrick* was to remedy a competitive disadvantage experienced by American fuel oil manufacturers caused by a federal duty upon the importation of crude petroleum. See 309 U.S. at 427. The bonded warehouse statutes considered in *Xerox* were enacted "to encourage merchants here and abroad to make use of American ports" and "to stimulate business for American industry and work for Americans." 459 U.S. at 151. Exempting bonded goods from import duties, the Court found, encourages those engaged in foreign trade to transship goods through American ports and stimulates the shipbuilding industry. See 459 U.S. at 150-151.

In both cases, the Court found the imposition of state taxes on the bonded goods to be incompatible with the policies underlying the Customs duty exemptions granted by Congress. The *McGoldrick* Court concluded that the imposition of a local sales tax upon the transfer of possession of fuel oil would frustrate the objectives of the federal regulation exempting the fuel from Customs duties:

> It is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duty.

309 U.S. at 429. The *Xerox* Court followed *McGoldrick*, concluding that the state tax was large enough "to offset substantially the very benefits Congress intended to confer by remitting the duty." 459 U.S. at 153.

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did not alter the *Xerox* Court's conclusion "that the ad valorem taxes [were] preempted by the statutory scheme." 459 U.S. at 152 n.8.

The common thread in *McGoldrick* and *Xerox* is that the imposition of each state tax substantially reduced the benefit provided to goods dedicated to foreign commerce. In analyzing these cases, the Court noted that "[t]he difference in the types of taxes in the two cases was of no importance, for imposition of either [a sales or a property] tax would detract from the benefit accruing to the importer from the waiver of the duty." *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 143 n.10 (1986). In other words, "[b]ecause the [federal government's] waiver of import duties [in *Xerox*] so clearly furthered the Act's purposes, any attempt to remove its benefit, such as would occur through State taxation, was incompatible with these goals." *Id.* at 143.

McGoldrick and *Xerox* compel a finding of preemption here. The primary means selected by Congress to facilitate the use of containers is the waiver of Customs duties. Tennessee's sales tax of $158,012 upon Itel's container leases is "large enough * * * to offset substantially the very benefits Congress intended to confer" by relinquishing $178,550 in duties. *Xerox*, 459 U.S. at 153. Like the American fuel oil manufacturers in *McGoldrick* and the American shipbuilders in *Xerox*, the imposition of Tennessee's tax upon Itel, an American container leasing company, discourages the use of "United States-owned and operated containers." Because more than $84 billion in American exports are carried in containers annually, the routine application of state sales and use taxes to containers will frustrate "the American export drive."

More fundamentally, however, the frustration of federal policy is not limited to the Tennessee tax's effect on American industry. While the federal statutes in *McGoldrick* and *Xerox* benefited only American interests, the Container Conventions are designed generally to benefit all signatories by encouraging the use of containers internationally and thus lowering the cost of transporting cargo. This purpose of the Conventions would fail if Tennessee "were free at any stage of the transaction to

impose a tax which would lessen the * * * advantage conferred" by its provisions. *McGoldrick*, 309 U.S. at 429. Indeed, the United States' interest in the regulation of Customs-bonded containers is even more compelling than its concern with the regulation of imported crude oil in *McGoldrick* or the transshipment of copy machines in *Xerox*. That is because containers also are the subject of international treaties that prohibit local taxes, a factor not present in *McGoldrick* or *Xerox*. As the system of federal container regulation is just as pervasive as the bonded warehouse system examined in those cases, the United States regulatory scheme has left Tennessee no room to impose general sales taxes upon containers.

The court below offered two reasons for declining to follow *McGoldrick* and *Xerox*, which seem self-evidently controlling here. First, it found the decisions inapposite because, while the warehouse statutes were designed to benefit American shippers and ports, "the Court in *Japan Line* found no Congressional intent to benefit container companies in the statutes regulating cargo containers." Pet. App. 10a. But that reasoning involves an obvious *non sequitur*. Observing that the warehouse statutes and the Container Conventions serve different purposes (even if that observation is correct) has nothing to do with the question whether the purposes served by *both* sets of provisions are defeated by state taxation.[17] And in fact, the federal policy underlying the Container Conventions that was identified by the Court in *Japan Line—general* facili-

[17] In fact, the court below was incorrect if it meant to suggest that American participation in the Conventions was not designed to benefit American container operators. As explained above, *supra*, at 17-18, President Johnson, in his message to the Senate, noted that the 1956 Convention was "of special importance to those Americans engaged in business in foreign countries" and would "aid the American export drive." President Nixon later explained that the "[1972] Convention is important because it will insure United States-owned containers the same treatment in the territories of States parties to this Convention as that afforded in the United States to foreign-owned containers." Exec. X, 93d Cong., 1st Sess. iii (1973).

tation of the use of containers—is frustrated by a state tax in precisely the same way as were the federal goals at issue in *McGoldrick* and *Xerox*.

The Tennessee court also found preemption inappropriate because, in its view, "Congress' regulation of cargo containers is less pervasive than its regulation of bonded warehouses." Pet. App. 14a. In fact, the court was simply wrong in this; the relevant regulations (which were not so much as cited by the court below) and the Conventions themselves (whose terms were wholly ignored by the court) impose elaborate requirements relating to the admission, operation, and design of containers that parallel those imposed on Customs warehouses.[18]

[18] See 1972 Convention art. 3-8, 988 U.N.T.S. 45-46 (temporary admissions facilities and procedures); art. 9, *id.* at 46 (conditions on use of containers granted temporary admission); art. 10-11, *ibid.* (admission of parts and accessories); art. 12, *id.* at 47 (approval of containers used to transport goods under Customs seal); Annex 1, *id.* at 51-52 (identification and marking of containers); Annex 2, *id.* at 52 (obligation of container owners to provide detailed records concerning movement of temporarily admitted containers and to pay duties when condition of admission not satisfied); Annex 3, *id.* at 52 (use of containers in internal traffic); Annex 4, *id.* at 52-61 (technical conditions on design and structure of containers); Annex 5, *id.* at 61-67 (procedures for approval of containers). Federal regulations adopted under the authority of 19 U.S.C. 1322 and 19 U.S.C. 66 serve to comprehensively implement the directives of the Conventions: 19 C.F.R. 10.41a (excepting containers from the requirement of entry and payment of duties); 19 C.F.R. 113.66(a) (bond conditions); 19 C.F.R. Pt. 115 (procedures for approval and certification of containers). These regulations require that containers certified for transport under Customs seal meet the stringent design and construction requirements provided by the Container Conventions. Containers must be used solely in international commerce to qualify as "instruments of international traffic." In the event that a container is damaged, regulations detail the conditions under which it may be repaired or destroyed without the imposition of duties. Container owners must execute a special bond before release of containers into the United States. If a container is diverted to intrastate or interstate commerce, regulations provide for the payment of duties and liquidated damages. Neither the federal

More fundamentally, the state court's observation about the pervasiveness of federal regulation also is beside the point. Whether or not the container regulations are as detailed as those governing Customs bonded warehouses, the crucial factor here is that the Tennessee tax frustrates federal policy. Cf. *R.J. Reynolds Tobacco*, 479 U.S. at 148-149. *McGoldrick* and *Xerox* make clear that preemption is required in such circumstances.[19] Again, the United States took the position in *Japan Line* that the bonded warehouse provisions are "analogous" to the 1956

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implementing statute nor the regulations allow local taxation of containers.

While it is true that goods in Customs warehouses are held under the supervision and control of Customs officers (see 19 C.F.R. 19.4; *Xerox*, 459 U.S. at 147-148 & n.2) while containers are not, that is wholly a function of the practicalities of container operation; containers, of course, must remain in continuous movement along with the goods they transport. That does not detract either from the pervasiveness of the container regulations or from the force of the policies underlying those regulations. Indeed, while Customs officers cannot accompany every container on every journey, the 1972 Convention takes the next best step by providing that "the owner or operator [of the container] * * * will undertake in writing * * * to supply the Customs authorities, * * * at their request, detailed information concerning the movements of each container granted temporary admission including the dates and places of entry into and exit from [the] country." Annex 2(2)(b)(i), 988 U.N.T.S. at 52.

[19] The court below also seemed to suggest that preemption is inappropriate because 19 U.S.C. 1322(a) excepts instrumentalities of foreign commerce only from the Customs laws; the court concluded that "[t]he regulations adopted pursuant to that statute, therefore, can go no further than to provide exceptions from federal customs duties." Pet. App. 13a; see *id.* at 9a. In fact, however, the Conventions *themselves*, which of course have the force of federal law, expressly preclude taxes in addition to Customs duties. In any event, the state court's observation hardly serves to distinguish *McGoldrick* and *Xerox*, which found preemptive force in statutes that in terms addressed only Customs duties. And the property tax disapproved in *Japan Line* as inconsistent with the 1956 Container Convention was no more a Customs duty than is the sales tax at issue here.

Convention (No. 77-1378, U.S. Br. at 25), concluding that "[t]he rationale of *McGoldrick* applies here as well." *Id.* at 27 (footnote omitted). That reasoning was correct, and preemption accordingly is warranted in this case.

II. APPLICATION OF STATE SALES TAXES TO CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE VIOLATES THE FOREIGN COMMERCE CLAUSE

Japan Line. The decision that established the prevailing test for examination of state taxes on foreign commerce, *Japan Line*, providentially considered taxation of containers subject to the 1956 Container Convention. The *Japan Line* Court invalidated California's property tax on Japanese-owned containers used exclusively in foreign commerce. 441 U.S. at 437. Because taxation of foreign commerce creates an "enhanced risk of multiple taxation" and "may impair federal uniformity in an area where federal uniformity is essential," the Court concluded that such taxes must be scrutinized more closely than those on interstate commerce.[20] *Id.* at 446, 448. If a state tax either "creates a substantial risk of international multiple taxation" or "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments,'" the tax violates the Foreign Commerce Clause. *Id.* at 451.

California's property tax failed both prongs of the test. Since Japan collected a property tax on the full value of the containers, California's apportioned tax inevitably resulted in multiple taxation. *Id.* at 451-452. California's tax also prevented the United States from "speaking with one voice" in regulating foreign trade:

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[20] The tax must first satisfy the four-part test enunciated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), for taxation of interstate commerce.

> The desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the Customs Convention on Containers, which the United States and Japan have signed. [citation omitted]. Under this Convention, containers temporarily imported are admitted free of "all duties and taxes whatsoever chargeable by reason of importation." 20 U.S.T., at 304. The Convention reflects a national policy to remove impediments to the use of containers as "instruments of international traffic." 19 U.S.C. § 1322(a).

Id. at 452-453. The Court swiftly concluded that California's tax would "frustrate attainment of federal uniformity" because the risk of Japanese retaliation against American-owned containers was acute. *Ibid.* Moreover, if other States followed California's example, "foreign-owned containers [would] be subjected to various degrees of multiple taxation, depending on which American ports they enter," preventing the United States from "speaking with one voice" in international trade. *Ibid.*

The kinship between this case and *Japan Line* is striking. The articles taxed are identical. The containers were used exclusively in foreign commerce and regulated by one or both of the Container Conventions, 19 U.S.C. § 1322(a) and 19 C.F.R. § 10.41a. Federal Customs bonds secured the containers from diversion to domestic commerce. The containers were in constant transit save for time spent undergoing repair or awaiting loading and unloading of cargo. The containers engaged in no intrastate or interstate transportation of cargo except as continuations of international voyages. Any movements or periods of nonmovement of containers in the taxing jurisdiction were essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce. 441 U.S. at 436-37; Stip. 2, 21, 76, 77, 79, 82; Pet. App. 27a, 35a.

In nevertheless distinguishing *Japan Line*—which it evidently recognized otherwise would be controlling—the

Tennessee court found a difference of constitutional dimension between California's property tax and Tennessee's sales tax. See Pet. App. 16a. The court explained that "the transfer of possession of cargo containers is a discrete transaction, occurring only within Tennessee, which creates no risk of multiple international taxation." *Id.* at 14a (footnote omitted). As for the other concerns identified in *Japan Line*, the court similarly reasoned that none "are implicated by a sales tax on a discrete transaction occurring only in one jurisdiction." *Id.* at 16a. These conclusions, however, were far too facile: the Tennessee tax raises precisely the dangers to foreign commerce and to this nation's international relations that were dispositive in *Japan Line*.

A. Tennessee's Sales Tax Creates a Substantial Risk of International Multiple Taxation

Tennessee's Tax Invites Multiple Taxation. At the outset, the court below was simply wrong in suggesting that, because the taxable event occurs only in one jurisdiction, duplicative taxation is impossible in the case of a transaction tax. Tennessee's sales tax is imposed on the "full value" of the proceeds from container leases. Because Tennessee's only nexus with the lease transactions is a naked transfer of possession, foreign nations may impose a tax on other incidents of the leases, such as their execution, that occur within their borders. Others might tax the use of containers within their jurisdiction.

The prospect of such taxes is hardly hypothetical. As might be expected, some of the 59 Convention signatories and their innumerable political subdivisions—which among them employ every imaginable type of taxation—impose use taxes on leased goods. Others, such as the members of the European Community, assess value added taxes on lessees who make productive use of leased property. Were containers used in international commerce not specifically excepted from application of these value added taxes (see page 15 & n.13, *supra*), a lessee obtain-

ing a container in Tennessee and transporting it to Europe accordingly would be liable to pay a value added tax on precisely the same base as that already subjected to tax in the State—the gross proceeds of the lease.[21] And the prospect that foreign taxes of this sort could be directed at values already taxed by Tennessee are greatly compounded by the reach of the state levy: once a container is transferred to the lessee in Tennessee, the State applies its tax to all amounts paid throughout the course of what may be a very long and indefinite lease period.

The imposition of such foreign levies based upon the execution of the lease or use of the container is indeed equivalent to Tennessee's sales tax.[22] All are imposed on

[21] The member countries of the European Community typically define a "taxable person" to include any company that exploits "tangible * * * property for the purpose of obtaining income therefrom on a continuing basis." O.J. European Comm. (No. L 145) Art. 4 (1977) (Sixth Directive 77/388). EC member nations clearly would have sufficient taxing nexus to impose a tax upon leased containers used within their borders since "the place where [taxable] transport services are supplied is the place where the transport takes place, having regard to the distances covered." *Id.* art. 9(2)(b). And each taxing jurisdiction applies the tax to "everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser." *Id.* Art. 11(A)(1)(a). The United Kingdom offers an example of this effect, describing the operation of its tax statutes. See U.K. Br. 8.

[22] Tennessee itself recognizes the equivalence between its sales tax and compensating use taxes by providing a sales-tax offset for use taxes that are paid to other States when *interstate* commerce is involved. Tenn. Code Ann. 67-6-313(f) (1989), -507 (1990). While the Court has formally reserved in the interstate setting whether a State that imposes a compensating use tax is constitutionally compelled to provide a credit for sales tax paid elsewhere (see *Williams v. Vermont*, 472 U.S. 14, 23 n.7 (1985)), it seems plain that the taxes are equivalent. See *Henneford v. Silas Mason Co.*, 300 U.S. 577, 583-587 (1937); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 31 (1988) (the "taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States"); *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989) ("to the extent that other States' telecommunication taxes pose a

the full value of the same lease. And, as explained by the United Kingdom (Br. at 7-9), foreign nations have a sufficient taxable nexus to tax the lease proceeds. That the labels selected by Tennessee and foreign nations to characterize their taxes are different "does not permit [the] Court to forgo examination of the actual tax base * * *. 'A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.'" *Trinova Corp. v. Michigan Dept. of Treasury*, 111 S. Ct. 818, 829 (1991) (citation omitted).

The risk that foreign nations will apply equivalent taxes to container leases is real. In the event that this Court rules that the imposition of the tax is not preempted by the Container Conventions, the remaining 44 States that impose a form of sales taxation will likely follow Tennessee's example. The other 58 signatory nations that have relinquished their right to collect revenues on containers will be encouraged to respond by taxing all container leases or singling out containers owned or leased by American companies. Because Tennessee's tax is based upon "full value," like Japan's tax in *Japan Line*, even if a foreign nation "should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results." *Japan Line*, 441 U.S. at 447.

In the face of this prospect of multiple taxation, the lower court's conclusion that "the transfer of possession of cargo containers in Tennessee is a discrete transaction, occurring only within Tennessee, which creates no risk of multiple international taxation," was based upon a plain misreading of this Court's decision in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986). The *Wardair* Court's conclusory remark dismissing the risk of multiple taxation arising from a sales tax on aviation fuel was based upon the taxpayer's concession

risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation").

and unique circumstances concerning the product taxed. The *Wardair* court found that Article 24(a) of the Chicago Convention on International Civil Aviation prohibited States from taxing aviation fuel that is " 'on board an aircraft * * * on arrival * * * and retained on board on leaving' a contracting party; it does not prohibit taxation of fuel purchased in that country." *Id.* at 10. In addition, as the United States explained, aviation fuel is a product that is consumed during the journey to the next potential taxing jurisdiction. U.S. Br. in support of prob. jur., No. 84-902, at 31. Thus, fuel sold in Florida could not be subjected to a multiple tax burden upon arrival abroad.

Multiple Taxation of Foreign Commerce. Duplicative taxation invariably has been deemed fatal to state levies in the interstate context because, by making an interstate transaction more expensive than an equivalent one that is performed entirely within one State, such taxes "exert[] an inexorable hydraulic pressure on interstate businesses to ply their trade within" one State "rather than 'among the several States.' " *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 286-287 (1987) (citation omitted). See, *e.g.*, *Japan Line*, 441 U.S. at 446, 447; *Evco v. Jones*, 409 U.S. 91, 94 (1972); *Standard Oil Co. v. Peck*, 342 U.S. 382, 384-385 (1952). That conclusion applies with greatly increased force in the setting of foreign commerce, where "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456.

The propriety of this understanding—that a state tax cannot survive when it is the cause of inevitable multiple taxation—is confirmed by the Court's decision in *Container Corp.* There, the Court upheld California's method of apportioning foreign source income to itself for purposes of its corporate income tax, rejecting the claim that the use by other nations of differing income allocation methods would lead to impermissible multiple taxation. But the Court added that, "[i]f California's method of formula apportionment 'inevitably' led to double taxation * * * that might be reason enough to render it suspect." 463 U.S. at 192-193. See *Japan Line*, 441 U.S. at 455 ("This case * * * involves no mere mathematical imprecision in apportionment; it involves a situation where true apportionment does not exist and cannot be policed by this Court at all"). Here, Tennessee seeks to tax the full value of container leases, rather than apportioning the value of the lease by time or distance. Accordingly, the fact of multiple taxation flows from the nature of Tennessee's tax, in contrast to the dilemma in *Container Corp.* of trading one allocation method that "sometimes results in double taxation" in favor of another that creates the same risk. 463 U.S. at 193.[23]

It is plain, moreover, that when duplicative taxation is present the state tax must yield to the one imposed by a foreign nation. Holding in *Japan Line* that even an apportioned state tax must fall when it leads to duplicative taxation of foreign commerce, the Court emphasized that a state levy "must be evaluated in the realistic framework of the custom of nations. Japan has the right and the power to tax [the taxpayers'] containers at their full value; nothing could prevent it from doing so." 441 U.S. at 454. Indeed, the impossibility of assuring foreign

[23] If that conclusion is not sufficient to invalidate the tax, the other factors also considered by the Court in *Container Corp.*—"the context in which the double taxation takes place and the alternatives reasonably available to the taxing state" (463 U.S. at 189)—also militate against the Tennessee tax's constitutionality. Tennessee may "entirely eliminate one important source of double taxation simply by adhering to one bright-line rule: do not [impose a sales or use] tax, to any extent whatsover, [on] cargo containers 'that are * * * used exclusively in international commerce * * *.' " *Id.* at 189-90, quoting *Japan Line*, 441 U.S. 444. To require Tennessee to adhere to this rule is "by no means unfair, because the rule [does] no more than reflect consistent international practice and express federal policy." *Id.* at 190.

compliance with our notions of tax equity requires that the state levy fall even when it is the foreign tax that is in some sense the more responsible for the duplicative taxation. "In interstate commerce, if the domiciliary State is 'to blame' for exacting an excessive tax, this Court is able to insist upon rationalization of the apportionment. * * * [H]owever, this Court is powerless to correct malapportionment of taxes imposed from abroad in foreign countries." *Ibid.*[24]

The "Risk" Test. Although the Court did not reach the question in *Japan Line* (see 441 U.S. at 452 n.17), it plainly should not matter to this analysis that Itel's lease transaction now faces the *risk*, rather than the *actuality*, of multiple taxation. In assessing claims of duplicative taxation in the interstate setting, the Court has regarded it as elementary that "the constitutionaliy of [one State's] tax should not depend on the vagaries of [another State's] tax policy." *Mobil Oil Co. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980). The reason for that is manifest: "The immunities implicit in the Commerce Clause and the potential taxing power of the State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." *Freeman v. Hewit*, 329 U.S. 249, 256 (1946). See generally *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 242 (1987); *Armco Inc. v. Hardesty*, 467 U.S. 638, 644-645 (1984). That reasoning has greatly magnified force in the international context, where the laws of more than 50 nations and thousands of subnational units intersect.

[24] Here, of course, there is no sense in which Tennessee has the greater entitlement to impose its tax: value added taxes are regarded as entirely legitimate by "the custom of nations" and are, in fact, among the most widely used form of taxation in the world. Having said this, it of course bears emphasis that, apart from international obligations such as the Container Conventions, it is within the power of Congress either itself to impose duplicative taxes on foreign commerce or to authorize such taxes by the States. But unless it does so, the States must take the international regime of taxing authority as they find it, and must refrain from the imposition of duplicative taxes that will have a destructive effect on the conduct of international trade.

In fact, a test that turned on the presence of actual multiple taxation would be both unmanageable and wholly divorced from the purposes of the Commerce Clause. Having the validity of a tax depend upon whether the taxpayer *already had paid* a tax in another jurisdiction—a sort of "first-come, first-tax basis'" (I J. Hellerstein, *State Taxation*, § 4.6[1][b] at 119 (1983))—would simply be irrational; it would have taxing power turn on the order of particular transactions and the alacrity of the local taxing authorities. And in the setting of foreign commerce, a test that looked to whether other taxing jurisdictions *actually had tax laws on the books* that might be employed against the taxpayer would require United States courts to master the tax laws of many other jurisdictions, while inviting continuing disputes about the equivalence (and thus about the economic substance) of foreign taxes that are based on unfamiliar theories. Such a test also would be impossible to administer when the tax at issue involved a sale or lease of property that was to travel in foreign commerce to destinations (and taxing authorities) not yet identified. See generally *id.* at 117-120.

Indeed, a requirement of actual multiple taxation would have an especially perverse effect in this case. Other nations have specifically withheld exercise of their taxing authority against containers in deference to the Container Conventions, as part of an attempt to encourage unrestricted international trade. Having the forbearance of those nationse validate Tennessee's tax would be a peculiar irony that cannot be required by the policies underlying the Foreign Commerce Clause.

Discriminatory Scheme of Tax Credits. The harmful effects of the duplicative taxation threatened by the Ten-

nessee system is compounded by a related element of the state tax regime: it discriminates against foreign and in favor of interstate commerce. In *Japan Line*, California imposed a non-discriminatory apportioned tax that collided with Japan's right to tax the "full value" of the containers. Here, Tennessee has chosen to "prevent actual multi-state taxation" by providing a credit for compensating taxes "paid in another state" without providing a corresponding credit for taxes paid in a foreign nation. Tenn. Code Ann. 67-6-313(f). Thus, while the full value of intrastate and interstate container leases may be taxed only once, Tennessee does not even attempt to relieve container leases from multiple foreign tax burdens.

B. Tennessee's Tax Prevents the United States From Speaking With One Voice in Regulating Foreign Trade

While the prospect of duplicative taxation is enough to invalidate application of Tennessee's tax, the "one voice" test articulated in *Japan Line* provides an independent basis to scuttle the tax. The tax fails the "one voice" standard if it "*either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Container Corp.*, 463 U.S. at 194. The Court has recognized that the second consideration is "essentially a species of pre-emption analysis." *Ibid.* For the reasons explained above, the collision between the purposes of the Container Conventions and Tennessee's tax makes clear that the levy cannot survive that inquiry. But the tax also must fall because it "implicates foreign policy issues which must be left to the Federal Government." *Ibid.*

Interference with Foreign Relations. In *Japan Line*, California's taxation of Japanese-owned containers implicated foreign policy issues because it created a risk of retaliatory taxes upon American-owned containers in Japan. *Japan Line*, 441 U.S. at 453. Like California's

property tax, Tennessee's sales tax on containers is "a novel state tax [that] creates an asymmetry in the international tax structure" (*id.* at 450)—a proposition that the Tennessee court did not dispute. Instead, the court asserted that the risk of foreign retaliation is not "implicated by a sales tax on a discrete transaction occurring only in one jurisdiction." Pet. App. 16a. This *ipse dixit* is insupportable.[25]

There is no reason to doubt that imposition of Tennessee's sales tax on containers owned by foreign container lessors will invite retaliation by other nations.[26] And the prospect that the Tennessee tax will irritate foreign interests is not limited just to its direct effects on foreign lessors. Although the legal incidence of Tennessee's sales tax falls upon Itel, a Delaware corporation headquartered in California, state law mandates that the tax be separately stated on the bill submitted to the lessee and requires that the tax "be collected by the retailer from the consumer insofar as it can be done." Tenn.

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[25] In *Wardair*, which involved a Florida sales tax similar to the one at issue here, Justice Blackmun, the only Member of the Court to reach the constitutional issue, flatly rejected reasoning of the sort relied upon by the state court here. As he explained, "[t]he tax imposed in this case by Florida * * * is indistinguishable, for Commerce Clause purposes, from the tax imposed by California on containers in *Japan Line*." 477 U.S. at 18 (Blackmun, J., dissenting). That was the case, he continued, because "other countries may react to Florida's tax with various retaliatory measures against United States carriers abroad, retaliation that 'of necessity would be felt by the Nation as a whole.'" *Id.* at 20, quoting *Japan Line*, 441 U.S. at 453. The Court held in *Wardair* that the Federal Government had affirmatively permitted application of the Florida tax, notwithstanding the levy's effects on foreign commerce. *See* 477 U.S. at 3-4, 9-10, 12. The Court expressly reserved the question discussed by Justice Blackmun, noting that "nothing in this opinion should be understood to address[] whether, in the absence of the international agreements [permitting state taxation], the Foreign Commerce Clause would invalidate Florida's tax." *Id.* at 13.

[26] The record establishes that at least one foreign container owner transfers containers to lessees in Tennessee. Tr. 89-90.

Code Ann. 67-6-502. This obligation to collect the tax from the lessee is mandatory. See *Hooten v. Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Indeed, a seller or lessor who fails to collect the tax at the time of the transaction may bring an action against the purchaser or lessee for the amount due or paid. See *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-55 (Tenn. App. 1989).

Thus, the practical and legal burden of the tax falls in substantial part on Itel's lessees, 80% of which during the tax period were steamship lines domiciled in foreign countries. Tr. 31-33. Most of those nations have signed the Container Conventions (Tr. 30-31) and thus now refrain from collecting taxes on the transfer of containers. But if forced to pay the tax, Itel's foreign customers may well demand that their governments impose corresponding tax burdens on American shipping companies who lease containers overseas. "The risk of retaliation * * *, under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 453. As in *Japan Line*, "[t]his result, obviously, would make 'speaking with one voice' impossible." *Ibid.*

The prospect of retaliation here, it should be emphasized, is not hypothetical. The United Kingdom, in its submission to this Court, has represented that "[i]f the United States were now to interpret the Convention other than in the manner in which it has been uniformly implemented for decades, the United Kingdom and other nations of similar persuasion are not likely to tolerate a situation in which they refrain from imposing taxes while U.S. political subdivisions impose theirs." U.K. Br. at 10-11. Not surprisingly, the Court has rejected the contention that a State is free to impose such "demonstrable burdens" on the commerce of the United States. *Japan Line*, 441 U.S. at 454.

The Need for a Uniform National Rule. The substantial likelihood that it will provoke retaliatory action by

other nations is not the only way in which the Tennessee tax "would make 'speaking with one voice' impossible." *Japan Line*, 441 U.S. at 453. The area of container taxation is one that, the United States and its trading partners have made clear through their actions, must be addressed at a national level. Yet, as in *Japan Line*, "[i]f other States follow [Tennessee's] example * * *, foreign-owned containers will be subjected to various degrees of multiple taxation, depending on which American ports they enter." *Id.* at 453. At the same time, Tennessee's tax, while of parochial benefit to that one State, will increase the price both of containers traveling through the United States and of the cargo exported in them. As the Court has suggested in a related setting, that will have "harmful effects on American industry and workers" by discouraging use of American ports and the consumption overseas of American goods. *R.J. Reynolds*, 479 U.S. at 145. The requirements of the Foreign Commerce Clause surely mean that Tennessee, "by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

Itel's Domestic Domicile. It is worth adding that, for present purposes, it is immaterial that Itel is a domestic domiciliary. The court below, of course, disclaimed reliance on that consideration. See Pet. App. 7a-8a. It may be that, in certain factual circumstances, a tax on domestic taxpayers will be less likely than one on foreign concerns to disturb international relations. Cf. *Container Corp.*, 463 U.S. at 195. But that is not the case here. The tax here *must* be passed on to Itel's customers, most of whom are foreigners who surely will complain to their governments. That is powerfully demonstrated by the support accorded Itel in this Court by associations both of domestic and foreign container lessors and lessees. See Br. of Asia North America Eastbound Rate Agree-

ment, *et al.*; Br. of Cronos Containers, *et al*; Br. of Pacific Merchant Shipping Ass'n, *et al.* And it is particularly telling that the United Kingdom has taken the unusual step of expressing its views to this Court—and that many of our trading partners have filed a diplomatic note challenging the Tennessee tax—in a case that does not involve one of their domiciliaries. As in *Japan Line*, the state tax thus plainly prevents the United States from speaking with one voice in regulating foreign trade.

III. TENNESSEE'S TAX VIOLATES THE IMPORT-EXPORT CLAUSE

A. The Purpose of the Clause

The Import-Export Clause provides that "No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its Inspection Laws." U.S. Const. Art. I, § 10, cl. 2. In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), the Court explained the purpose of the Clause: "In effect, the Clause was fashioned to prevent the imposition of exactions which were no more than transit fees on the privilege of moving through a State." *Id.* at 290 (citing *License Cases*, 5 How. 504, 575-576 (1847) (Taney, C.J.)). While the Court has explained that "the term 'Impost or Duty' is not self-defining and does not necessarily encompass all taxes" *Washington Revenue Dept. v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 759 (1978)), the Court has never construed the Clause to permit the type of state tax imposed by Tennessee—a direct tax on goods merely in transit through the State.

Indeed, it was commonly understood at the Constitutional Convention of 1787 that States were not to be permitted to place direct taxes on exports. During the debate on the last draft of the Tax Clause (Art. I, § 8, cl. 1), James Madison, contending that the Federal

Government should have the power to tax exports, argued that since "*the States cannot with propriety exercise it [the power of taxing exports] separately*, it ought to be vested in them collectively." 2 M. Farrand, *The Records of the Federal Convention of 1787*, p. 306 (1911) (emphasis added). Later, the predecessor to the Import-Export Clause was amended by "insert[ing] after the word 'imports' the words 'or exports' *so as to prohibit the States from taxing either.*" *Id.* at 442 (emphasis added).

By definition, cargo containers that are traveling in international commerce pursuant to the Conventions have characteristics both of imports and of exports; they have arrived in this country from overseas and will immediately leave as part of a continuous journey. The imposition of a tax on these containers, which are "instrumentalities of foreign commerce, both as a matter of fact and as a matter of law" (*Japan Line*, 441 U.S. at 445-46), cannot be reconciled with the Import-Export Clause.

B. The *Richfield* Decision

It is undeniable that the Tennessee tax is unconstitutional under the principles announced in this Court's earlier holdings applying the Clause, where "the dispositive question was whether the goods had entered the 'export stream,' the final, continuous journey out of the country." *Washington Stevedoring*, 435 U.S. at 752. The Court thus held in *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946) that California's sales tax imposed on a shipment of oil bound for New Zealand violated the Import-Export Clause. Like the tax here, the state tax invalidated in *Richfield* was a generally-applicable sales tax levied on sellers "[f]or the privilege of selling tangible personal property at retail," who in turn were "authorized to collect the tax from the consumers." 329 U.S. at 83. The *Richfield* Court dismissed the State's attempt to label the tax as a mere

"privilege" tax that did not fall directly on the goods and determined that where "the incident which gave rise to the accrual of the tax was a step in the export process" (*id.* at 84), the tax constituted an impost upon an export and therefore was unconstitutional. *Id.* at 86.

Richfield is on all fours with the situation here: it invalidated a general state sales tax upon the transfer in the taxing jurisdiction of goods that were being sent abroad. The Tennessee tax therefore may survive only if *Richfield* no longer is good law.

C. The *Michelin* Analysis

As the Fifth Circuit recently noted, "*Richfield* has not been overruled." *Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816, 819 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990). In *Michelin* and *Washington Stevedoring*, however, the Court announced a new test to determine whether a nondiscriminatory state tax levied on imported or exported goods no longer in transit violates the Import-Export Clause. This approach looks at the three policies that underlie the Clause:

> [T]he Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the other States not situated as favorably geographically.

Michelin, 423 U.S. at 285-286 (footnotes omitted); see *Washington Stevedoring*, 435 U.S. at 752-53.[27]

[27] The *Washington Stevedoring* Court stated that a State tax on exports "can be tested for its conformance with the first and third policies" enunciated in *Michelin*. 435 U.S. at 758. The second policy —protecting federal revenues—is not implicated because the Constitution forbids federal taxation of exports. U.S. Const., Art. I, § 9, cl. 5; see *Washington Stevedoring*, 435 U.S. at 758.

The *Michelin* Court held that the state property tax in that case did not violate any of the three policies, but emphasized that the levy was imposed "on imported goods *that are no longer in import transit.*" 423 U.S. at 286 (emphasis added); see *id.* at 302 (goods "were no longer in transit"). In so holding, the Court strongly suggested that the imposition of a tax on goods that *are* in transit could not stand, noting that "[i]n effect, the Clause was fashioned to prevent the imposition of exactions which were no more than transit fees on the privilege of moving through a State." *Id.* at 290 (footnote omitted). The Court therefore explained that the third purpose of the Clause "may be secured merely by prohibiting the assessment of even nondiscriminatory * * * taxes on goods which are merely in transit through the State when the tax is assessed." *Ibid.*

In *Washington Stevedoring*, the Court noted this limitation on the *Michelin* holding and left open the possibility that state taxes on goods in transit remain unconstitutional. Because the tax in that case fell "upon a service distinct from the goods and their value" (435 U.S. at 757), the *Washington Stevedoring* Court upheld Washington's business and occupation tax on stevedoring services. In so holding, the Court stated that it did "not reach the question of the applicability of the *Michelin* approach when a State directly taxes imports or exports in transit." *Id.* at 757 n.23.

Most recently, in *R.J. Reynolds*, the Court again "observed that in *Michelin* [the Court] limited its holding to the imported goods 'no longer in transit.'" 479 U.S. at 154 (citation omitted). The Court upheld the property tax there at issue because the imported material had

"nothing transitory about it." *Id.* at 155. *Richfield* is reconcilable with *Michelin* and *Washington Stevedoring* on that basis: the goods subject to the state sales tax in *Richfield* were in transit (they were actually heading into the hold of a foreign vessel) when the levy attached. See *Richfield* 329 U.S. at 82-83.

D. The *Richfield* Holding Is Valid After *Michelin*

In our view, the instinct that led the Court repeatedly to suggest that state taxes on goods in transit may be *per se* unconstitutional is sound. As one of the leading commentators in this area has explained, a

> basis for deciding the in-transit tax cases under the new Import-Export jurisprudence may be found in the purpose of the clause to prevent the seaboard States from exacting a tax on "goods merely flowing through their ports." A sales tax on goods being exported that is imposed at the point of delivery of title and possession of the goods to the purchaser or his shipper for transport to the purchaser can be fairly regarded as such an exaction and, therefore, as a "transit fee" that is repugnant to the Import-Export Clause.

I Hellerstein, *supra* § 5.4 at 189-90 (footnotes omitted). The Fifth Circuit has come to an identical conclusion, holding recently that the Clause invalidates "a [state sales] tax that is levied on the goods themselves while they are in transit." *Louisiana Land*, 900 F.2d at 820.

This case graphically demonstrates the wisdom of such an approach. The containers subject to tax simply pass through Tennessee en route to other destinations. The containers' only contact with the State is their delivery there to a common carrier for transfer elsewhere in the first step of an export journey; indeed, the containers were not subjected to tax *until* they were delivered to a common carrier for transport overseas. Tennessee thus is taking advantage of its "favorabl[e]" location (*Michelin*, 423 U.S. at 286) as a convenient spot for the transfer of containers to "exact[] a tax on 'goods merely flowing through [its] ports.'" I Hellerstein, *supra*, at 189. That aspect of the levy is made especially clear by the operation of the tax: once possession of a container is transferred in Tennessee, the State continues to tax the proceeds as the lessees' per diem obligations add up throughout the extended life of the lease. Tennessee thus asserts that, once the containers have passed through the State, it is permitted to impose a continuing tax on them as they accompany import and export shipments around the world. This is surely an appropriate setting for the invalidation "of even nondiscriminatory * * * taxes on goods which are merely in transit through the State when the tax is assessed." *Michelin*, 423 U.S. at 290.

It is worth adding that, if the Import-Export Clause is not understood to establish a *per se* bar on the taxation of goods in transit, it will serve hardly any purpose at all. The first and third elements of the *Michelin* test are essentially identical to policies already effected by the Commerce Clause, while the second *Michelin* policy has no bearing in cases involving exports.[28] Yet the

[28] The first element, which looks to the necessity that the Federal Government speak with "one voice when regulating commercial relations with foreign governments," requires "the same inquiry as to the effect of a state tax as the Foreign Commerce Clause." *Japan Line*, 441 U.S. at 449 n.14. The third prong of the *Michelin* test, the Court has added, is satisfied so long as the state tax satisfies the four-part *Complete Auto* test governing burdens on interstate commerce. See *Washington Stevedoring*, 435 U.S. at 754-755, 761. And the second *Michelin* factor (which certainly was not the principal policy underlying the Import-Export Clause, see generally *Michelin*, 423 U.S. at 283-285) does not come into play in cases involving exports. Although the Court has expressed skepticism that *per se* Import-Export Clause rules are necessary to distinguish that provision from the Commerce Clause (see *Washington Stevedoring*, 435 U.S. at 759), it did so before it announced the "one voice" Commerce Clause test in *Japan Line*.

Import-Export Clause "states an absolute ban [on imposts and duties], whereas the Commerce Clause merely grants power to Congress." *Washington Stevedoring*, 435 U.S. at 751. A firm bar against the taxation of goods in transit thus gives the former Clause an independent purpose that fulfills its role as a guarantor of "harmony among the States." *Michelin*, 423 U.S. at 286.[29]

In nevertheless rejecting Itel's Import-Export Clause argument, the court below ignored the fact that Itel's containers were in transit when the tax was assessed. Rather, the court found it crucial that "the transfer of possession of cargo containers is a discrete transaction"; that "Tennessee's tax only compensates the state for providing protective services, so the tax will not disturb harmony among the states"; and that "the indirect nature of the tax distinguishes it from the direct taxes held invalid in *Xerox* and *McGoldrick*." Pet. App. 18a. But this reasoning plainly is without substance. For reasons we explain above, a tax on a discrete transaction may preclude the Federal Government from speaking with "one voice" in its relations with foreign nations. The boilerplate suggestion that the State provides protection to containers traveling through its jurisdiction does not distinguish the Tennessee tax from any transit fee. See I Hellerstein, *supra*, at 187. And the sales tax here is no less directly imposed on the subject goods than were the sales taxes invalidated in *Richfield* and *McGoldrick*. Indeed, the Court has made clear that "[i]n *Richfield*, the tax fell upon the sale of goods and was overturned because the Court had always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale had no value or significance apart from the goods."

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[29] Of course, for the reasons that we explain above in connection with the Commerce Clause, the Tennessee tax fails the "one voice" test. Thus, even without a *per se* ban under the Import-Export Clause, the Tennessee tax cannot survive scrutiny under the *Michelin* test.

Washington Stevedoring, 435 U.S. at 756 n.21. That is true here as well.

CONCLUSION

The decision of the Tennessee Supreme Court should be reversed.

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